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FOREIGN CURRENCY EXCHANGE RATE FLUCTUATION FUNDS.(U)
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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

INTERNATIONAL DIVISION

B-146749

AUGUST 31, 1981

The Honorable Caspar W. Weinberger
The Secretary of Defense

Dear Mr. Secretary:

Subject: Foreign Currency Exchange Rate Fluctuation Funds (ID-81-54)

We reviewed the contingency funds approved by the Congress to cover shortages in Defense's overseas programs caused by foreign currency exchange rate fluctuations. The objective of our review was to evaluate the effectiveness of procedures for using and accounting for these funds, which total $1.1 billion.

We found the procedures to be generally effective, but noted inconsistencies among the Military Services in handling exchange rate fluctuations for some programs and activities and a few relatively minor operating deficiencies. (See enc. 1.) Therefore, we recommend that the Secretary of Defense:

1. Issue guidelines to ensure that the Services uniformly account for gains and losses due to foreign currency exchange rate fluctuations in military construction and family housing programs. As long as this contingency funding approach is continued, this accounting should be made whether or not funds had been made available in the current year.

2. Determine whether gains and losses from foreign currency fluctuations for travel expenses are significant, and then establish a uniform policy for handling these transactions.

Defense officials commented that there are unresolved differences of opinion within Defense as to whether the Military Services should account for gains and losses due to currency exchange rate fluctuations in fiscal year 1981 military construction and family housing programs. Some officials contend that, since no contingency funds were made available in fiscal year 1981, it is not necessary to account for exchange rate fluctuations. We disagree with this position, because Congress intended that any gains should be accounted for and held for possible transfer to the contingency funds. Gains would have been recorded in fiscal year 1981 due to the favorable U.S. dollar fluctuations.

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In commenting on our second recommendation, Defense officials said that foreign currency exchange rate fluctuations for travel expenses were determined to be insignificant and that Defense has not yet decided whether a uniform policy should be established.

Enclosures II and III show gains and losses due to exchange rate fluctuations for 14 foreign currencies and for the individual Military Services.

Our review primarily concerned contingency fund operations in fiscal year 1980 and the first 2 months of fiscal year 1981. In planning our work, we considered the results of a Defense Audit Service review of fiscal year 1979 fund operations. We examined selected vouchers and related documents at Army, Navy, and Air Force finance offices in Germany and Japan, where the need for contingency funds has been the greatest. We also obtained information at field command headquarters in Europe and Hawaii, the Office of the Secretary of Defense, and the Services' headquarters and finance centers. Enclosure IV lists the field locations we visited.

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and to the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report. We would appreciate receiving copies of these statements. In addition, we would appreciate being informed of the action taken on the matters we brought to the attention of local officials during our review.

We are sending copies of this report to the Secretaries of the Army, Navy, and Air Force and to cognizant congressional committees.

Sincerely yours,

Frank C. Conahan

Frank C. Conahan
Director

Enclosures - 4

INTRODUCTION

In our April 7, 1978, report (ID-78-33), we recommended that a new funding approach be approved to eliminate problems that foreign currency exchange rate fluctuations were causing Defense in managing overseas programs, particularly operations and maintenance. Congress subsequently approved contingency funds totaling $1,095 million to cover differences between budgeted and actual Defense foreign currency costs caused by unfavorable exchange rate fluctuations. These funds were appropriated as follows.

Fiscal year	Operations and maintenance and military personnel	Military construction and family housing
	(millions)	
1979	$500	-
1980	470	$125
1981	-	-
Total	$970	$125

Congress intended that any gains from favorable exchange rate fluctuations should be accounted for and held for possible transfer to the contingency funds.

The contingency funds are centrally managed by the Office of the Secretary of Defense, which issued overall policy guidance for use of these funds to the Military Services and Defense agencies and directed them to develop accounting and reporting procedures. The funds were available to liquidate program obligations for prior, current, and future years. Funds are transferred to the Services and agencies based on justified requests.

In general, the military disbursing offices submit monthly summary reports of variances (gains/losses) for each foreign currency subject to exchange rate fluctuations to their accounting and finance centers. The centers consolidate the reports and submit this information to headquarters for further consolidation into a monthly Defense-wide report. Navy procedures are somewhat different and are discussed on page 6 of this enclosure.

As of December 31, 1980, net losses in operations and maintenance and military personnel programs totaled $791.1 million; $732.5 million of the loss had been realized and $58.6 million 1/

1/Current market exchange rates as of Dec. 31, 1980, were used in estimating the accrued loss. When these obligations are liquidated, however, the current rate at that time will be used to determine the realized variance. Thus, the realized variance will be more or less than the accrued variance, depending on the actual rate at the time the obligations are liquidated.

had been accrued on unliquidated obligations. Contingency funds of $699.8 million were made available to cover realized losses. The remaining realized losses of $32.7 million were absorbed by the military personnel appropriations. This left a contingency fund balance of $270.2 million to cover future losses. ($970.0 million less $699.8 million).

The decline in the dollar's value against the German mark was by far the major reason for program losses. The net loss was $595.8 million, based on a realized mark loss of $597.1 million which was offset by a small accrued gain of $1.3 million. Throughout fiscal years 1979 and 1980, the actual value of the dollar did not exceed the budgeted exchange rate of 2.24 marks to the dollar. For fiscal year 1981, the budget rate was changed to 1.78 marks to the dollar and gains have been experienced. On August 17, 1981, the exchange rate was 2.5235 marks to the dollar.

The decline in the value of the dollar against the Japanese yen also contributed to the net loss position at December 31, 1980. Yen losses totaled $148.4 million--$102.2 million realized and $46.2 million accrued. These losses were incurred throughout fiscal year 1979. There were some gains in 1980, but overall a net loss was incurred. Losses were also incurred in 1981. The exchange rate used in the budget for fiscal years 1979 and 1980 was 245.15 yen to the dollar, and for fiscal year 1981 it was 247 yen to the dollar. On August 17, 1981, the exchange rate was 235.50 yen to the dollar.

Beginning with fiscal year 1981, military personnel costs are excluded from the foreign currency contingency funds. Defense requested, and the Congress approved, this exclusion because it was difficult to separate the effect of exchange rate fluctuations from other factors that cause changes in military personnel housing and cost of living allowances in foreign countries. These allowances are paid to individuals in U.S. dollars and, therefore, the military personnel accounts are not directly affected by currency exchange rates as are the operations and maintenance accounts. Through fiscal year 1980, $215 million in contingency funds had been used to cover shortages in military personnel accounts.

As of December 31, 1980, the net loss in military construction and family housing programs totaled $190.5 million, $105.4 million of it realized and $85.1 million 1/ accrued. Additional funds will be required to finance any realized loss in excess of the $125 million then available or the loss will have to be absorbed by the operating appropriations.

The exchange rates for marks and yen used in the fiscal year 1979 and 1981 budgets for military construction and family housing programs were the same as those used in the budgets for oper-

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1/See footnote on p. 1.

ations and maintenance programs. In fiscal year 1980, however, lower exchange rates were budgeted for these currencies for military construction and family housing programs. Thus, variances in these fiscal year 1980 programs were more favorable (i.e., lower losses or higher gains) than variances in operations and maintenance programs, and they will continue to be so as obligations are liquidated.

The exchange rates used in the budgets for this 3-year period are shown below.

Table 1

Budgeted Exchange Rates

Fiscal year	Currency	Operations and maintenance	Military construction and family housing
1979	Marks	2.24	2.24
1980	Marks	2.24	2.09
1981	Marks	1.78	1.78
1979	Yen	245.15	245.15
1980	Yen	245.15	209.15
1981	Yen	247.00	247.00

The fiscal year 1980 exchange rate for military construction and family housing differs from the operations and maintenance rate to reflect the fact that military construction obligations would be incurred over several years and a lower value of the dollar was considered more appropriate.

DETERMINATION OF BUDGET RATE

Defense now establishes a budget exchange rate based on current rates in the New York market. The Defense Comptroller's Office establishes budget rates and provides them to the Military Services for their use in budget preparations. When budget submissions are consolidated into Defense's part of the President's budget, Defense updates the initial submission to reflect current market rates. Initial budget preparation usually occurs in October, with consolidation and submission to the President's budget occurring in November. For example, Defense's submission to the President's budget for fiscal year 1982 was based on market rates at the end of November, 1980--1.95 marks and 213.20 yen to the dollar.

Defense's return to the use of current market rates is a response to congressional criticism over the use of November 1977

exchange rates for the fiscal years 1979 and 1980 budgets (see table 1). Congress believed that Defense should have used the more recent November 1978 rates for preparing the fiscal year 1980 budget because the dollar had improved since November 1977; it was concerned that use of the earlier November 1977 rates would cause Defense to spend the fluctuation fund rather than move money into it for future use if the dollar declined.

We share this congressional concern and believe that Defense should use current rates in budget preparation. Defense has done this for fiscal years 1981 and 1982 and should continue to do so.

NEED FOR UNIFORM PROCEDURES TO ACCOUNT FOR CURRENCY FLUCTUATIONS

There are inconsistencies among the Military Services in accounting for foreign currency exchange rate fluctuations in construction and family housing programs and in travel expenses of operations and maintenance programs. We believe that uniform Defense-wide procedures are needed to ensure that all significant gains and losses from currency fluctuations are accounted for.

Military construction and family housing

In fiscal year 1980 and continuing into fiscal year 1981, the Air Force has accounted for gains and losses in military construction and family housing programs. The Navy has not accounted for these variances. A Navy official said that the Navy has no large overseas construction and housing programs, so exchange rate fluctuations have not been a major problem. The Army accounted for gains and losses in these programs during fiscal year 1980 but has discontinued this procedure for fiscal year 1981 programs. In October 1980, Army headquarters advised the overseas commands that, since there will be no foreign currency fluctuation appropriation for fiscal year 1981, they should not compute gains and losses for fiscal year 1981 construction and housing programs. The commands were instructed to continue accounting for variances in prior years' programs.

It appears that the Army would be showing a gain in fiscal year 1981 construction and housing programs if it were accounting for these foreign currency fluctuations. Marks are the major foreign currency required in those Army programs, and the dollar's value has been above the budget rate of 1.78 marks to the dollar since the start of the fiscal year.

Recommendation

We recommend that the Secretary of Defense issue guidelines to ensure that the Services uniformly account for gains and losses due to foreign currency exchange rate fluctuations in military construction and family housing programs. As long as this contingency funding approach continues, this accounting should be made whether or not funds had been made available in the current year.

Travel expenses

The Defense Audit Service review of fund operations for fiscal year 1979 noted inconsistencies both within and between the Services in the handling of travel reimbursements. The Defense auditors reported that the Army and Marine Corps did not record currency fluctuations for travel reimbursement, the Air Force recorded fluctuations if the traveler showed the exchange rate on the travel voucher, and some Navy disbursing offices reported fluctuations but others did not. The auditors concluded that Defense should determine whether travel reimbursements are affected significantly by foreign currency fluctuations and should establish a uniform policy for handling these transactions.

In our limited review of travel vouchers, we noted that the Air Force and the Army have continued their respective practices; that is, the Air Force computes the variances for travel expenses and the Army does not. The amounts involved did not appear to be significant, and they may not be worth the effort required to make the currency fluctuation adjustments.

Recommendation

We recommend that the Secretary of Defense determine whether gains and losses from foreign currency fluctuations for travel expenses are significant and then establish a uniform policy for handling these transactions.

AGENCY COMMENTS

Defense officials commented that there are unresolved differences of opinion within Defense as to whether the Military Services should account for gains and losses due to currency exchange rate fluctuations in fiscal year 1981 military construction and family housing programs. Some officials contend that, since no contingency funds were made available in fiscal year 1981, it is not necessary to account for exchange rate fluctuations.

We disagree with this position. In fiscal year 1981, the U.S. dollar has fluctuated favorably in relation to the budgeted exchange rates for most currencies. In our opinion, therefore, Defense would not need additional contingency funds for military construction and family housing programs.

Since Congress intended that any gains from favorable exchange rate fluctuations should be accounted for and held for possible transfer to the contingency funds, we believe our recommendation remains valid.

If all the Military Services were accounting for exchange rate fluctuations in fiscal year 1981, we believe that Defense would show a realized gain in these programs. This gain would reduce losses realized in prior years, thereby increasing the contingency funds available for the future. For example, from Decem-

ber 31, 1980 to April 30, 1981, the accrued loss or gain for military construction and family housing programs changed from an accrued loss of $85.1 million to an accrued gain of $7.7 million. The realized loss as of April 30, 1981, was $110 million. Thus, funds appropriated for the programs in fiscal year 1980 could cover this loss and still leave a fund balance of about $15 million. ($125-$110). Moreover, this fund balance would have been more had the Army been accounting for fiscal year 1981 programs.

In commenting on our second recommendation, Defense officials said that foreign currency exchange rate fluctuations for travel expenses were determined to be insignificant and that Defense has not yet decided whether a uniform policy should be established.

OTHER MATTERS

We noted a few operating deficiencies at some locations we visited. These matters, as discussed below, were brought to the attention of local officials, who agreed to take corrective action.

Army

Army regulations require that disbursing offices establish and maintain an auditable record for all vouchers processed involving foreign currency fluctuations. Disbursing offices may prepare a summary voucher reflecting the gain or loss by program and currency but must attach a list of the individual voucher numbers to the summary voucher. We found that finance offices in the V and VII Corps in Germany were using summary vouchers for some types of transactions but were not attaching lists of the supporting vouchers. Army officials in Germany promised that corrective action would be taken to ensure that an adequate "audit trail" would be available in the future.

Navy

The monthly payroll voucher for Japanese nationals (about $5 million) is the largest individual transaction processed by the Navy disbursing office in Yokosuka, Japan. We were unable to verify the total gain from favorable yen-dollar fluctuations shown on payroll vouchers because the vouchers did not include the variances associated with certain payroll adjustments. When we brought this matter to the attention of local officials, they provided the additional information needed to verify the gain and agreed that this information should appear on future payroll vouchers.

Navy disbursing offices are responsible for reporting liquidated obligations for foreign currency fluctuation transactions, and this is being done on a current basis. The disbursing offices, however, do not report variances related to the liquidated obligations. Instead, paid vouchers are sent to the Fleet

Accounting and Disbursing Centers for processing and reporting on the variances. We noted that this procedure was causing a 2- to 3-month delay between reporting on liquidated yen obligations and reporting on gains and losses related to those obligations.

Officials at the Pacific Fleet Accounting and Disbursing Center said they are trying to reduce the delay in reporting to one month. We believe that Navy reports on foreign currency fluctuation obligations and gains or losses should identify in a footnote the period for which variances are not included.

STATUS OF FOREIGN CURRENCY FLUCTUATIONS FOR OPERATIONS AND MAINTENANCE AND MILITARY PERSONNEL PROGRAMS AS OF DECEMBER 31, 1980

Country	Currency	Losses or -Gains Realized	Losses or -Gains Accrued (note a)	Total
		-----(millions)-----		
Belgium	Franc	$ 24.1	$ .4	$ 24.5
Canada	Dollar	-6.0	-1.1	-7.1
Denmark	Kroner	.1	-	.1
France	Franc	16.3	-1.4	14.9
Germany	Mark	597.1	-1.3	595.8
Greece	Drachma	-4.6	-2.4	-7.0
Italy	Lira	10.6	-3.1	7.5
Japan	Yen	102.2	46.2	148.4
Netherlands	Guilder	10.9	.2	11.1
Philippines	Peso	-.6	-.3	-.9
Portugal	Escudo	-2.8	-.4	-3.2
Spain	Peseta	24.6	-3.4	21.2
Turkey	Lira	-103.6	-4.8	-108.4
United Kingdom	Pound	64.2	30.0	94.2
Total		b/ $732.5	$58.6	c/$791.1
Activity				
Army		$505.0	$ 2.1	$507.1
Navy		d/ 64.1	25.4	89.5
Air Force		121.0	21.8	142.8
Marine Corps		14.4	6.6	21.0
Defense agencies		28.0	2.7	30.7
Total		b/ $732.5	$58.6	c/$791.1

a/Accrued variance computed on basis of actual exchange rates at Dec. 31, 1980. Realized variance will be determined by actual exchange rates at time obligations are liquidated.

b/Foreign currency fluctuation funds amounting to $699.8 million were provided to cover the variance. The remaining variance of $32.7 million was absorbed by military personnel appropriations.

c/Due to favorable U.S. dollar exchange rate fluctuations, the total loss after December 31, 1980, would have been reduced.

d/Realized variance is not current due to reporting delays. We found the delay to be 2 to 3 months.

STATUS OF FOREIGN CURRENCY FLUCTUATIONS FOR MILITARY CONSTRUCTION AND FAMILY HOUSING PROGRAMS AS OF DECEMBER 31, 1980

Country	Currency	Losses or -Gains Realized	Accrued (note a)	Total
		-----(millions)-----		
Belgium	Franc	$ 10.9	$30.7	$ 41.6
Canada	Dollar	0.0	0.0	0.0
Denmark	Kroner	0.0	0.0	0.0
France	Franc	0.0	0.0	0.0
Germany	Mark	83.2	36.6	119.8
Greece	Drachma	0.0	-.6	-.6
Italy	Lira	.6	-.1	.5
Japan	Yen	-2.1	.7	-1.4
Netherlands	Guilder	2.1	.6	2.7
Philippines	Peso	-.1	0.0	-.1
Portugal	Escudo	.1	-.1	0.0
Spain	Peseta	.1	.1	.2
Turkey	Lira	1.4	-.8	.6
United Kingdom	Pound	9.2	18.0	27.2
Total		$105.4	$85.1	b/$190.5
Activity				
Army		$ 82.2	$54.0	$136.2
Navy		-	-	-
Air Force		22.9	24.5	47.4
Marine Corps		-	-	-
Defense agencies		.3	6.6	6.9
Total		$105.4	$85.1	b/$190.5

a/Accrued variance computed on basis of actual exchange rates at Dec. 31, 1980. Realized variance will be determined by actual exchange rates at time obligations are liquidated.

b/Due to favorable U.S. dollar exchange rate fluctuations, the total loss as of April 30, 1981, had been reduced to $102.8 million--$110.5 million in realized losses offset by $7.7 million in accrued gains.

FIELD ACTIVITIES VISITED

ARMY

U.S. Army Finance and Accounting Center
Indianapolis, Indiana

Headquarters, U.S. Army, Europe
Heidelberg, Germany

V Corps, 18th Finance Section
Frankfurt, Germany

VII Corps Regional Finance and Accounting Office
Stuttgart, Germany

21st Support Command, 45th Finance Section
Kaiserslautern, Germany

U.S. Army Finance and Accounting Office
Camp Zama, Japan

NAVY

Commander-in-Chief Pacific Fleet
Pearl Harbor, Hawaii

Fleet Accounting and Disbursing Center, Pacific
San Diego, California

U.S. Naval Supply Depot
Yokosuka, Japan

AIR FORCE

Air Force Accounting and Finance Center
Denver, Colorado

Headquarters, U.S. Air Force, Europe
Ramstein Air Base, Germany

86th Tactical Fighter Wing Finance Office
Ramstein Air Base, Germany

475th Air Base Wing Finance Office
Yokota, Japan